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Family values

Delivering long-term growth

Globally, we've talked to more than 1,600 business owners and managers. This report discusses the UK results and discovers how family businesses are dealing with the economic downturn, what challenges they're facing and how they're preparing for the future.

pwc

Foreword

The second PwC Global Family Business Survey provides a valuable insight into the current trends in the family business sector across the world. This UK report also underpins why the sector is increasingly drawing attention from the media, intermediaries and academics, as well as policy makers. Trust in business was eroded during the recent financial crisis and this has helped throw the spotlight on the family business sector as a source of economic stability. With lower borrowings, relative restraint in terms of staff redundancies and shorter lines of communication, family firms have on the whole been able to weather the tough times. As long as confidence continues to increase and investment levels are restored to historically higher levels, the future for the family business sector will be bright.

Grant Gordon

Institute for Family Business (IFB), Director General

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Preface

The longer-term, generational perspective of family businesses, and their lower reliance on external financing, has served them well during these tough economic times

Family businesses are a potent driving force behind the UK's economy. They employ around 9.5 million people in the UK, more than all of the FTSE companies combined. They account for 31% of the country's GDP (double the private equity sector's share) and contribute 15% of the government's total tax revenues[1].

There's nothing quite like a family business – whatever its size or the market it operates in, a family business will behave and be run in a way that is unique. Whereas listed companies are driven by their shareholders, by their management and by the demands of the market, family companies are driven by the needs of the business, by the owners, and by the dynamics of the family. Sometimes all of these elements combine harmoniously, but sometimes they don't.

The most successful family firms have found a good balance between these three ingredients, and show professional management, responsible business ownership and a harmonious family dynamic. But the characteristics that make a family business exceptional can also make it precarious. An unhealthy conflict between family members, whether it's a dispute about money or infighting when the business passes from one generation to the next, can spill over into the way the business is managed. If relations within the family are healthy, the business is more likely to be healthy. Solid, mutually supportive bonds help to encourage loyalty to the company, make people more motivated and make for better decision-making – qualities that mean the business itself is better equipped to deliver strong results.

The most successful family companies are those that are well aware of the conflicting pressures they could face and plan well to tackle them before they arise. They tend to have clear written agreements about the composition of the board and the election of senior executives, the decisions that require a majority vote and a clear procedure to determine which family members can (or can't) work in the business. They have robust governance procedures, they bring in outside directors and managers where necessary, and they monitor the performance of relatives who are working for the business, just as they do the performance of outside directors and managers.

These companies are also careful to separate ownership issues from family issues. The most long-lasting family firms typically have rules about how shares can (or can't) be traded inside and outside the family, and when shares can be sold. In other words, they have a reliable system in place to make sure that the business is stable and has a sustainable strategy for growth while maintaining the family's control. And they make sure that the needs of the family itself are given due weight. If most of the family's financial resources are tied up in the company, it may be reluctant to take risks that might actually be good for the business. The best businesses spread the family's risk and investments well, protecting the business as well as the family.

In short, in many of the best, most enduring family firms there are clear boundaries between the business, the owners and the family, and any discussion about ownership and family matters take place outside the boardroom. And they make separate financial arrangements, if that's

1 Source: The UK Family Business Sector report (IFB, 2008)

possible, for heirs who don't work in the business. These measures are particularly important when economic conditions are difficult, as they have been for many companies over the past two years.

Over the past few months we have talked to more than 1,600 family-business owners and managers in a wide range of sectors in 35 countries as we completed our second global Family Business Survey – the largest of its kind ever to be conducted (for details of our methodology and survey population, please see the Appendix). The survey explores the important issues that affect family firms, including the corporate challenges they face; ownership, succession planning and management pay; conflict resolution; and the regulatory and social changes that are highest on their list of priorities.

This report reviews the results of the research that was carried out with 100 participants in the UK, covering a broad range of business sizes and sectors. We wanted to learn how they have coped with the economic environment, what challenges they're facing and how they are preparing for the future. We also thought that family businesses would welcome the opportunity to compare their own experience with those of their peer groups, in the UK and around the world, and find out what they're doing to thrive.

The past two years have been a struggle for survival for many of the UK's companies but as the results of this survey show, the longer-term, generational perspective of family businesses, and their lower reliance on external financing, has served them well. The unique characteristics of a family business have allowed these not only to survive in a difficult economic environment, but to strengthen their foundations for the future.

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To view the full Global Family Business Survey 2010 report, visit www.pwc.com/fambizsurvey

Introduction

The past two years have been some of the most challenging in living memory for businesses around the developed world. But while family businesses, in the UK and elsewhere, have seen demand for their goods and services decline, all the indications are that they have coped well – and arguably better than many other companies – with the economic conditions.

Family businesses are not immune to recession; they face the same challenges that other companies face – and some of these challenges may be particularly difficult to manage because they involve emotional as well as commercial ties. But family businesses also enjoy several special advantages, as many who took part in our survey acknowledge.

Firstly, family businesses can take the long-term view. They are under less pressure than listed companies to deliver quarterly results and pay dividends to shareholders, and they rarely burden themselves with the same levels of debt. As a result, it's easier for them to adopt a long-term perspective and re-invest in the business when times are tough.

Recent research shows, for example, that family-managed companies are less likely to make employees redundant, and are less likely to make deep cuts, than other organisations[2]. The staff of family businesses may be more loyal as a result of this attitude, although it can obviously create challenges if a company needs to downsize to survive.

Secondly, most family firms have a relatively simple hierarchy and management structure. They don't need to consult lots of shareholders when difficult decisions must be made, and so can react more rapidly than their competitors.

Thirdly, many family firms have developed strong personal relationships with their customers. This is partly because their simpler structure allows them to respond more nimbly than other companies, but has also much to do with the fact that when your name's above the door, you're likely to work harder to maintain the company's reputation[3].

In short, family-run businesses are generally better able to cope with economic volatility than other companies because they are managed as long-term assets with a sustainable strategy. They can ride out storms that overturn many others.

What is a family business?

A family business is defined in this survey as:

- an enterprise in which the majority of the votes are held by the person who established or acquired the firm (or by his or her spouse, parents, children or children's direct heirs)
- at least one representative of the family is involved in the management or administration of the firm
- where the company is listed, the person who established or acquired the firm (or his or her family) possesses 25% of the voting rights through his or her share capital and at least one family.

2 Jörn Hendrich Block, Family Management, Family Ownership and Downsizing, Technische Universität München, 2008

3. A. Bakr Ibrahim, Jean McGuire and K. Soufani, An Empirical Investigation of Factors Contributing to Longevity of Small Family Firms, Global Economy & Finance Journal, Vol. 2, No. 2 (2009)

Weathering the storm

Demand for the products and services provided by family businesses has contracted sharply since the onset of the financial crisis. When we carried out the same survey in 2007, two thirds of family businesses in the UK said they had seen a 'modest' or 'significant' growth in demand over the previous 12 months, but we consider this to be a good overall performance considering the economic downturn. This year, just 40% told us that they had seen the same level of growth. If we compare these results to the global survey, the UK's family businesses seem to have suffered slightly more than average – almost half of family firms in the global survey of 35 countries said they had seen significant or modest growth in demand over the past year.

In such an environment it's hardly surprising that many family businesses are preoccupied with the state of their market. When we asked family businesses in the UK to name their top three external challenges, 70% mentioned market conditions (compared with 46% in 2007), while 42% said they were concerned about legislation and regulation (compared with 61% in 2007). When we asked about their internal challenges, 36% said they were worried about cash flow and controlling costs (compared with just over a quarter in 2007).

But the UK's family businesses are upbeat about the future, and with good cause. There's a strong sentiment that the UK's family businesses have coped well with the difficult trading conditions of the past two years, and the results of our survey support that view – 68% said that their operating profits increased or remained the same over the past year. Clearly, most have weathered the storm well.

Fewer companies are seeing growth in demand for their products/services

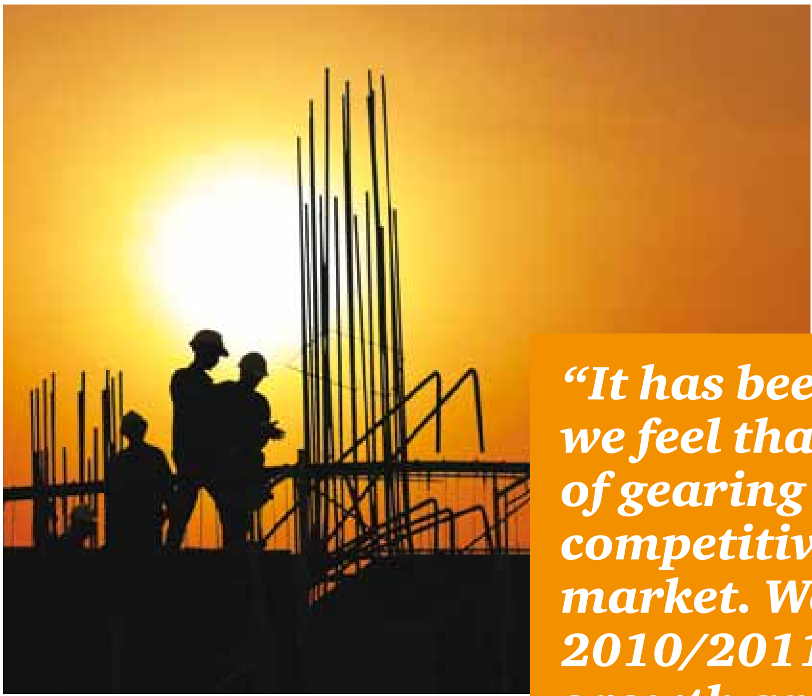
Q. Looking back over the past 12 months how would you describe the demand for your company's products/services compared to the previous 12 months?

Base: All respondents. 2010 – 100, 2007 – 102. Figures above show the sum of those that answered 'modest growth' or 'significant growth'

40% UK – 2010

vs

67% UK – 2007

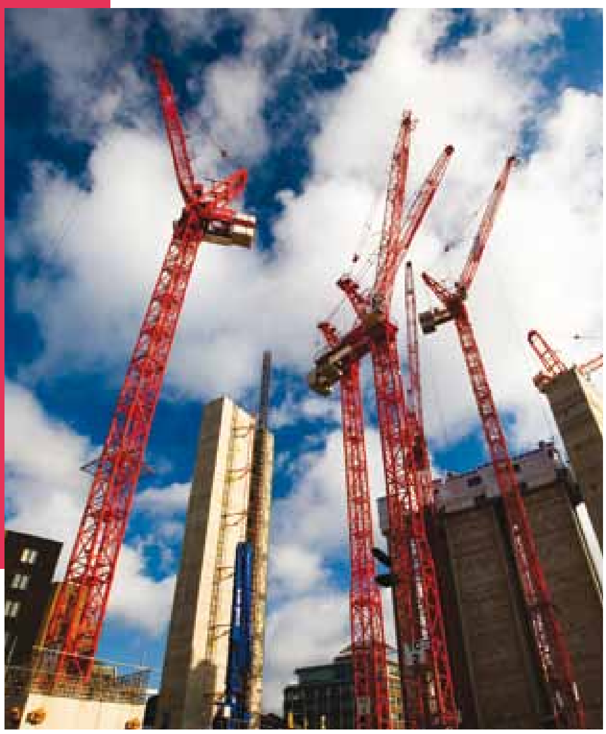


"It has been challenging but we feel that our modest levels of gearing have given us a competitive edge in a tricky market. We're expecting 2010/2011 to be a year of both growth and opportunity."

Nicholas Bewes
The Howard Group

"The market is highly competitive, with companies taking on long-term contract work with very slim or no margins, just to maintain revenue. We've stayed away from competing on those terms as far as possible and have used our cash balances to fund us through the tough times."

Second-generation
construction company



"I think my staff appreciate the continuity in the business. They prefer working for a family business like ours. The openness of management to future plans and the 'all in it together' mentality binds staff to the company."

Charles Hodgson
Hodgson Sealant Limited

The recession has not dented their ambition either, with 64% saying they are aiming to expand and grow over the coming year and 27% saying their plans include consolidation in the market. If we compare this against the global sample, the UK's family businesses are slightly more bullish – 60% of the global sample told us they were planning to grow and expand, and 25% were planning to consolidate. And we believe they are well-placed to carry their ambitions through, as they are carrying less debt than many of their non-family competitors, and so have greater flexibility to expand.

A family affair

So why have family businesses coped so well during the recession? For many, the secret is the simple fact of being a family business – many participants in the survey argued that the strong collective purpose they felt had helped to ease much of the anxiety, with 69% agreeing that being part of a family business had helped them through the crisis.

The wider explanation is more complicated but is closely aligned to the basic character of a family business. Family businesses have a sense of continuity and sustainability that is far greater than anything found in other companies. The owner's fundamental aim is to protect and increase the value of the business. This is both for past generations because of the desire to preserve the legacy of their parents or grandparents, and for future generations because they want to pass on something of increasing value to their children and grandchildren.

This mindset means that family businesses concentrate on performance and long-term potential. While many listed companies feel under pressure to focus on short-term results in order to maintain the share price and their shareholders' investment, family businesses are free to concentrate on long-term health and growth. This creates strong financial and strategic foundations that help them survive difficult economic conditions. Only 15% of family businesses, for example, told us that they intended to make major changes to their business model as a result of the financial crisis.

Their attitude to cash and reserves is another indication of this long-term way of thinking. Many companies have struggled to access bank finance since the credit crunch, which has severely dented their ability to withstand the recession and to invest for growth. But while family businesses in general tend to have strong and long-standing relationships with their bank, they are not as reliant on outside funding as many other companies. Their keenness to preserve the business when times are tough often results in an accumulation of cash as a protection strategy and willingness to defer dividends during difficult times have placed them in a strong position; 69% of family businesses questioned for the survey said they had access to surplus cash if they need it, and only one in ten said they had no reserves.

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Competition and opportunities

"Our long-term strategy is to build strong and sustainable brands. This requires significant investment over a significant period of time. If we were quoted, the market would demand a return on capital investment over a much shorter timeframe. Being unquoted allows us to make utterly unique decisions. This is a key advantage of being unquoted."

Peter Gordon,
William Grant & Sons Ltd

Looking for market share

We could sum up the mood of the UK's family businesses as being cautiously optimistic. Even though they are confident about the state of their business – 95% said they feel competitive in relation to market leaders in their sector – it is clear that they are facing a more constrained environment than before. While the majority are planning for growth and expansion, a third of UK family businesses believe that their core market will get worse over the next year, which means that their growth will have to come from an increase in market share rather than from an expansion in the market as a whole. If we compare this to the global survey, it's clear that the UK's family businesses are less hopeful about the prospects for market growth – fewer than one in five of family businesses we talked to for the global survey felt that their core market would deteriorate over the next 12 months.

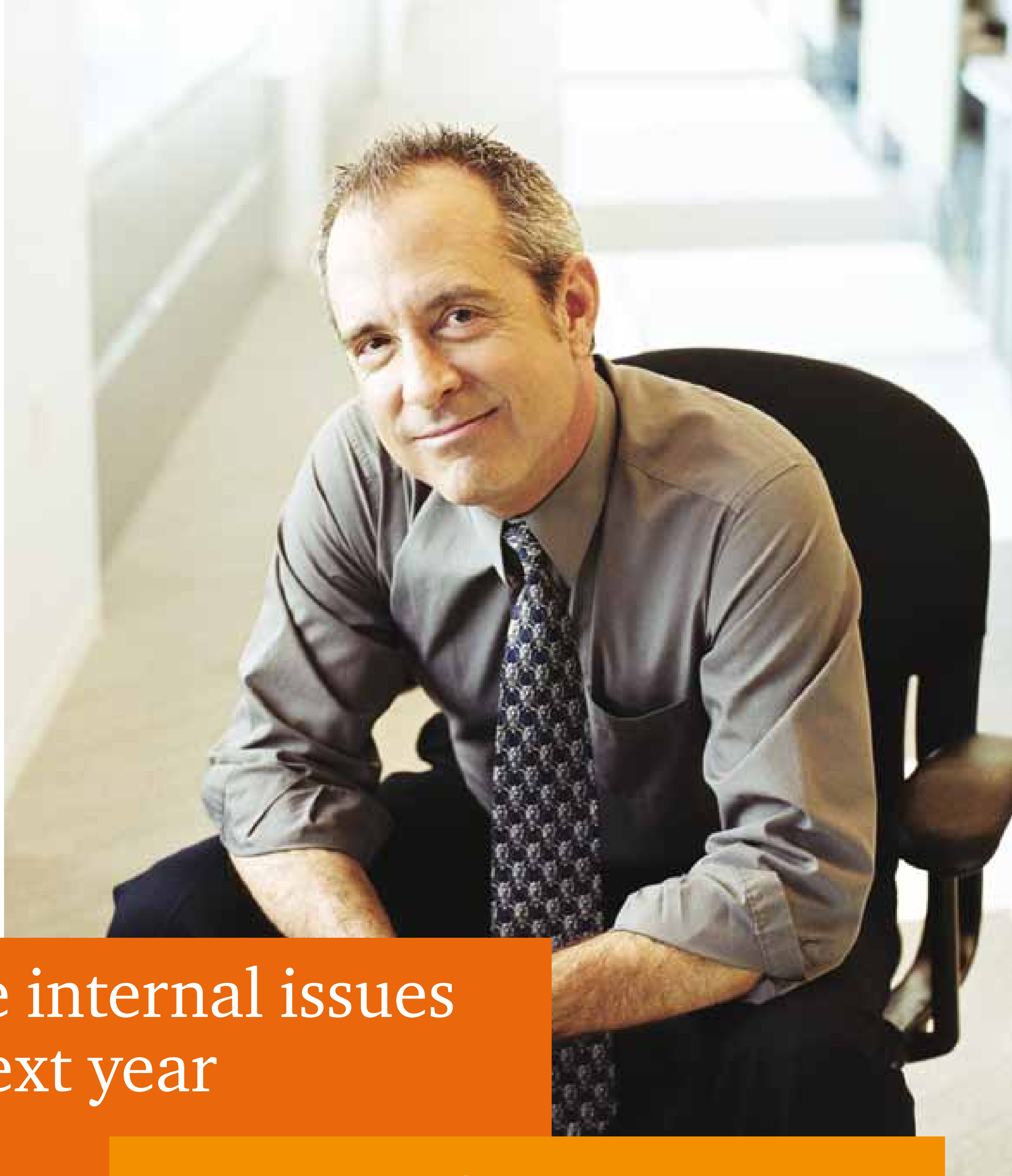
Even so, the UK's family businesses have a strong base from which to grow and most are in a good financial position to take advantage of opportunities as they arise. But in a competitive market it's important that they don't lag behind in their strategic investments.

The recession has taken its toll in terms of investment by family businesses in areas that will help provide the platform to maintain their domestic and global competitiveness. One in three told us that they had cut back on their capital expenditure in the past year and that their plans for investment in people and training, marketing and IT have all fallen sharply since we last carried out this survey in 2007. In fact, UK family businesses have cut back on their capital expenditure to a greater extent than their counterparts in other countries – only 25% in the global survey said they had decreased their capital expenditure over the past year (compared with 35% in the UK) and 32% had increased their spend (compared with 25% in the UK). This lower level of investment could place domestic companies at a disadvantage against overseas competitors in the future.

Family businesses are well placed to compete but need to challenge themselves to make sure they stay ahead of their competitors. This is especially important in areas such as strategic investment, which will allow them to exploit new markets and refine their products and services to meet the changing needs of their customers. They should also be sure that they are well-positioned to attract, retain and develop the talented people they need in order to compete effectively.

Competing for talent

Despite the strengths of their business model, one of the most critical issues for family businesses as the economy improves will be making sure that they can attract and retain good staff. Finding and recruiting talented people remains the most significant internal challenge faced by family businesses, with 46% naming it as a major issue for them. And as the recruitment market begins to pick up, family businesses will face even greater competition in the fight to attract talented people.



Top three internal issues for the next year

1. ***Recruitment of skilled staff/ labour shortages***
2. ***Cash flow/ Controlling costs***
3. ***Capacity/meeting orders***

> *"At the moment there is only one family shareholder on the board but the intention is to the keep the company under the control of family shareholders in the future. Several members of the family have recently started working for the company, developing the experience they need to understand the business."*
>
> *Manufacturing company*

The survey shows that family businesses use a variety of techniques to retain staff, such as career progression and challenging job opportunities, but 88% still told us that competitive salaries are their most important retention tool. Family businesses are not necessarily at a disadvantage when it comes to offering attractive pay packages – they have, for example, the ability to be more flexible than listed companies in their remuneration strategy because of their strong capital investment, private shareholder base and long-term perspective. The drawback is that they think they can't as readily offer the capital gains ticket that comes with substantial share options or a private equity-backed business start-up with exit potential. Instead, they must rely on basic tools such as bonuses, which are heavily taxed.

Even so, there are options open to family businesses that are not always considered. It is possible, for example, to structure share ownership in such a way that non-family management are able to participate in future capital growth, without undermining fundamental family ownership. And if done well, in the right circumstances, this can be a powerful strategy.

It's also encouraging to see an increasing trend for the use of deferred bonus schemes – 27% of family businesses said they were using deferred bonus plans for senior management, compared with 15% in 2007 – as this is an area where family businesses are well-positioned to compete with listed companies. Quoted companies build their deferred bonus schemes on share-based payments, which hold an uncertain future value. Family businesses, on the other hand, generally base their deferred bonus schemes for non-family members on cash payments, which do not fluctuate in value. And they say that their incentive plans work – 83% say that their plans have a positive effect on senior management.

Playing to family strengths

Family businesses have a distinct advantage in the recruitment market in that some candidates would actively choose to work for them, rather than for an equivalent listed company. This has worked well for them in the past and has ensured that they are usually able to attract talented executives and other employees who are drawn by their culture of sustainability. The long-term perspective of family businesses means they are seen as forward-looking, balancing performance with potential, and well-managed. But they are also perceived as having different values and rewarding different behaviour from quoted businesses.

We believe that this will become a significant advantage in the near future as Generation Y – those born after 1980 – progress in their careers. Companies of all sizes are already struggling to understand and meet the needs and expectations of this group of employees, who are so markedly different from their predecessors. But family businesses and Generation Y are, in many ways, a natural fit because both have an interest in 'doing the right thing'. These younger workers value social responsibility, sustainability and a focus on behaviour over short-term financial results – all of which they are likely to find in a family business. This generation has great potential and if family businesses are able to harness some of it, they will be in a powerful position.

Lingering concerns

An emotional business

Whether it's positive or negative, emotion is always involved when it comes to decision-making in a family business. Occasional conflict is a fact of life but in a family business it can be deeply divisive and sometimes destructive. It's often the case that disagreements become more pronounced as a business moves on through the generations and the ownership base widens. Fundamental family differences may only be kept under control as long as the older generation are still in charge.

The majority of businesses we spoke to said they didn't experience a great deal of tension, but any arguments that do arise tend to centre around recurring themes: the performance of family members involved in the business; a lack of consultation by family members working within the business with the wider family, who are less involved; and setting pay levels for family members who are actively involved in the business.

Seven out of ten businesses said they didn't have formal conflict procedures in place to resolve serious disagreements, which is a worrying statistic when you consider the damage that a family feud could cause. Of those that had procedures in place, a third-party mediator was a popular option, followed by a family council or constitution, or a shareholder agreement.

Disagreements are not the only crisis that can hit family businesses. We're concerned to see that a quarter of companies questioned had not made any plans to deal with the unexpected death of a key manager or shareholder, and only half had procedures in place that would allow them to buy shares from a family member who was incapacitated or had died. It's particularly important that family businesses – who, by definition, depend on continuity of management from generation to generation – make contingency plans to deal with the unexpected worst case scenario.

Keeping it in the family

Succession, of course, is a core principle for family businesses and two thirds of those questioned said they had a succession plan in place for at least some of the senior executive roles. This is a welcome increase from the 2007 survey, when just over half of family businesses had a succession plan in place. Two thirds of companies who had written a succession plan were expecting the business to be passed to other family members and 52% had already chosen their successor, compared with 30% in 2007. It's possible that this is a symptom of the tough economic climate, where businesses and the family look for certainty in an uncertain world.

An important element of succession planning in the UK is continuing uncertainty over the future of business property relief (BPR) which allows business assets to be passed through the generations without incurring crippling inheritance tax liabilities. Of the family businesses we spoke to 70% told us that BPR helped to reduce their exposure to inheritance tax and 63% felt that the existence of BPR encouraged them to invest in their business. It's hardly surprising then, that continuation of the relief is seen as vital; and 59% said they would probably have to change their long-term plans for the business if this relief was to change.

"As a guardian of the business, I want to pass it on to the next generation in a better condition than it was given to me."

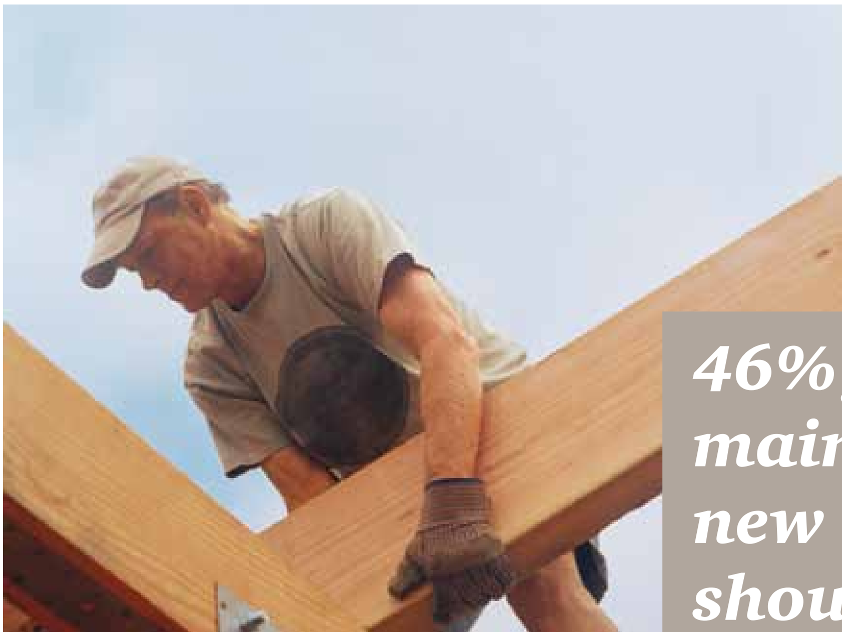
UK respondent

Inevitably, not all businesses will remain within the family: 22% of those questioned said they were anticipating a change of ownership of the business within the next five years. But of these, only a third expected the business to stay within the family. 32% expected to sell the business to its management team, and 27% expected to sell to another company or to a private equity investor. Only 9% were contemplating a flotation or initial public stock offering (IPO), which is not an unusually low proportion – most family businesses don't ever consider going public. Not because they are less ambitious than listed companies, more that they want to grow but will not compromise the belief that they can do so without resorting to public ownership.

Regulation worries

Tax and legislation tend to be recurring concerns for family businesses but are less prominent in this year's survey, with 42% of family businesses saying they were worried about regulation and government policy, compared with 61% in 2007. Most family businesses have had other things on their minds recently, that have taken priority but this is still a significant proportion. UK family businesses remain far more concerned about government policy than their global counterparts – only one in four family businesses globally name regulation as a serious concern.

Family businesses continue to see the tax regime in the UK as a barrier to growth, with 73% saying the tax system is not supportive of enterprise. However, only 17% agreed that simplifying the tax rules in the UK would be the most useful change that the government could make. Most (46%) felt that the main priority for the new government should be to reduce the administrative burden on businesses. What they crave most, though is a period of stability and a clear signpost for monetary and fiscal policy over the next five years.



46% felt that the main priority for the new Government should be to reduce the administrative burden on businesses

Conclusion

It’s been a tough couple of years for business. But what comes out clearly from the survey is that the nation’s family firms have performed admirably well during some of the most difficult economic conditions most have experienced. Their pragmatic conservatism and long-term perspective have proved to be valuable characteristics, which have allowed them to survive the recession in a healthier state than many other companies.

Most family businesses are in great shape. They have access to cash at a time when many other companies are struggling to raise finance, and their natural emphasis on stewardship and sustainability remains a quality that enables them to compete well in the recruitment market and attract talented employees. One respondent to the survey told us that their aim was to create a business “of which all stakeholders could be proud, because of its excellence of performance and its excellence of reputation in our community”. It’s an admirable aspiration, and shows an underlying character that will become much more valuable in the future as Generation Y – ideologically a natural fit with family businesses – progress in their careers.

It’s been a rough economic road but family businesses are very much in the long-term game. Other companies may chase the short-term opportunities but family businesses will remain solid, for a long time to come. We will leave the last word to one of our UK respondents: “We have been here for 90 years and we want to continue for another 90, just the way we are.”

Appendix:
Methodology and survey population

Our survey covers small and mid-sized family companies in 35 countries: Austria, Bahamas, Bahrain, Barbados, Belgium, Brazil, Canada, Cyprus, Denmark, Egypt, Finland, France, Germany, Ireland, Italy, Kuwait, Jamaica, Japan, Jordan, Malta, Netherlands, Norway, Oman, Russia, Saudi Arabia, South Africa, Spain, Sweden, Switzerland, Syria, Trinidad and Tobago, Turkey, United Arab Emirates, United Kingdom and United States. We interviewed top executives in 1,606 companies operating in 15 industry sectors between 26 May and 17 August 2010. All respondents were interviewed via a 20-minute telephone call, with the exception of respondents in Japan and Turkey, who were interviewed face-to-face. The research was coordinated by the PwC International Survey Unit, Belfast, our global centre of excellence in market research, which designed the questionnaire in conjunction with family business experts from PwC.

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